

REPORT OF EXAMINATION
OF THE
CALIFORNIA MUTUAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2010

Filed September 12, 2011

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San Francisco, California
July 21, 2011

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of

CALIFORNIA MUTUAL INSURANCE COMPANY

(also referred to as the Company) at its main administrative and statutory home office located at 650 San Benito Street, Suite 250, Hollister, California, 95024.

SCOPE OF EXAMINATION

The previous examination of the Company was made as December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2010. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners Handbook (Handbook). The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pension plans; stock ownership and insurance plans; business in force by states; loss experience; statutory deposits; and sales and advertising.

COMPANY HISTORY

The Company was incorporated under the laws of the State of California as the Farmers Mutual Fire Insurance Company of San Benito County and commenced operations on September 20, 1920. The Company changed its name to Mid-State Mutual Insurance Company in 1989. On September 8, 2006 the Company received approval to change its name to California Mutual Insurance Company.

MANAGEMENT AND CONTROL

The Company is a mutual insurer owned by its policyholders who numbered approximately 1,977 as of December 31, 2010. Management and control of the Company is vested in a seven-member board of directors elected annually. As of December 31, 2010, the directors and principal officers were as follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Kenneth Bettencourt Gilroy, California	Owner/Broker Ridgemark Realty
Elwood Dryden Hollister, California	Owner Dryden Farms
George E. Lim Corte Madera, California	Owner GE Lim and Associates
Steve I. Miller Hollister, California	President California Mutual Insurance Company

Directors (continued)

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
James E. Rollins Hollister, California	Retired
Sandy Rose Hollister, California	Retired
Edward Stephenson Hollister, California	Retired

Principal Officers

Steve I. Miller	President
Cheri L. Schmidt	Senior Vice President and Treasurer
Edward Stephenson	Secretary

Management Agreement

The Company entered into an administrative services agreement with an affiliate, Calvista Insurance Agency, Inc. (Calvista), effective January 17, 2008. Under the terms of the agreement, the Company provides administrative and facilities services to Calvista. The administrative services include financial reporting, tax compliance, treasury, budget and cost accounting, payroll and other various services. Calvista pays the Company for these services and facilities based on time allocations, expense sharing and actual cost. Under the terms of the agreement, the Company reported net receivable for the years 2008, 2009, and 2010 totaling \$70,603, \$109,930, and \$34,319, respectively. The California Department of Insurance abstained from objection to this agreement on January 17, 2008.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2010, the Company was licensed to write fire, surety, plate glass, liability, burglary, and miscellaneous classes of business in the State of California only. In 2010, approximately 70% of its \$3.7 million in direct premiums was commercial multiple peril business written on motels, strip malls, and other small businesses. The remaining direct premiums were written in the homeowners multiple peril line of business. All business is written through 75 agents and Company staff.

REINSURANCE

Assumed

The Company assumes 2% of a reciprocal catastrophe pool from the Mutual Reinsurance Bureau.

Ceded

Following is a schedule of the ceded reinsurance agreements in-force as of the examination date:

Type of Contract and Lines of Business	Reinsurer(s)	Company's Retention	Reinsurers' Limits
Multi-Line Excess of Loss Covers property fire, allied lines, inland marine, commercial multiple peril, homeowners multiple peril, farmowner multiperil, and earthquake (property sections). Casualty coverage Commercial multiple peril (liability), homeowner multiple peril (liability) and farmowners multiple peril (liability).	Endurance Re 50% Mutual Reinsurance Bureau 50%	\$250,000 per occurrence	<u>1st Layer:</u> \$250,000 excess of \$750,000 per occurrence
		\$1 million per occurrence	<u>2nd Layer:</u> \$1 million excess of \$1 million per occurrence
		\$2 million per occurrence	<u>Clash:</u> \$1 million excess of \$2 million per occurrence
Property per Risk Excess of Loss Covers Fire, allied lines,	Endurance 75%	\$4 million per occurrence	\$2 million excess of \$4 million per occurrence
	Mutual Reinsurance Bureau 25%		

Type of Contract and Lines of Business	Reinsurer(s)	Company's Retention	Reinsurers' Limits
inland marine, commercial multiple peril (property), homeowner multiple peril (property), farmowner multiple peril (property) and Earthquake.			
Property Catastrophe Excess of Loss	Mutual Reinsurance Bureau	\$600,000 per occurrence	<u>1st Layer:</u> \$1.4 million excess of \$600,000 per occurrence
Covers catastrophic loss on commercial multiple peril, homeowners multiple peril, fire, allied lines, inland marine, farmowners multiple peril and earthquake.		\$2 million per occurrence	<u>2nd Layer:</u> \$2 million excess of \$2 million per occurrence
		\$4 million per occurrence	<u>3rd Layer:</u> \$3 million excess of \$4 million
Excess of Loss - Casualty Facultative Covers commercial multiple peril.	Berkley Insurance	\$2 million per risk	Retention is determined on treaty by treaty basis
Excess of Loss – Property Facultative Covers commercial multiple peril	Munich Re	\$6 million per risk	Retention is determined on a treaty by treaty basis
Net Quota Share	Merced Mutual	75% of net liabilities	25% of net liabilities

The Company has a 100% Quota Share treaty with Travelers Indemnity Company, which covers boiler and machinery breakdown.

It was noted the multi-line excess of loss contract with Endurance Re effective January 1, 2010 and the quota share agreement with Merced Mutual effective January 1, 2010 did not contain an entire agreement provision as required by California Code of Regulations (CCR), Title 10, Chapter 5, Article 3, Section 2303.13.(b) in order to take statement credit. No adjustment was made as the amount of \$133,000 was immaterial. It is recommended that the Company revise these reinsurance agreements to comply with CCR, Title 10, Chapter 5, Article 3, Section 2303.13(b).

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders from December 31, 2006
through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 8,078,317	\$	\$ 8,078,317	
Preferred stocks	16,266		16,266	(1)
Common stocks	3,483,307	227,455	3,255,852	
Cash and short-term investments	884,239		884,239	
Receivables for securities	101,875		101,875	
Investment income due and accrued	107,232		107,232	
Premiums and agents' balances in course of collection	170,474	3,807	166,667	
Premiums, agents' balances and installments booked but deferred and not yet due	381,945		381,945	
Reinsurance other amounts receivable under reinsurance contracts	61,500		61,500	
Guaranty funds receivable or on deposit	22,016		22,016	
Furniture and equipment, including health care and delivery assets	10,177	10,177		
Receivable from parent, subsidiaries and affiliates	34,319		34,319	
Aggregate write-ins for other than invested assets	<u>31,359</u>	<u>5,000</u>	<u>26,359</u>	
Total assets	<u>\$ 13,383,026</u>	<u>\$ 246,439</u>	<u>\$ 13,136,587</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$1,093,659	(2)
Loss adjustment expenses			266,861	(2)
Commissions payable			94,900	
Other expenses			(12,326)	
Taxes, licenses and fees			(13,825)	
Current federal and foreign income taxes			(94,711)	
Net deferred tax liability			260,201	
Unearned premiums			1,735,986	
Advance premium			18,088	
Ceded reinsurance premiums payable			68,229	
Aggregate write-ins for liabilities			<u>28,200</u>	
Total liabilities		3,445,262		
Unassigned funds (surplus)		<u>\$ 9,691,325</u>		
Surplus as regards policyholders			<u>9,691,325</u>	
Total liabilities, surplus and other funds			<u>\$ 13,136,587</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2010

Statement of Income

Underwriting Income

Premiums earned		\$3,326,758
Deductions:		
Losses incurred	\$ 942,239	
Loss expenses incurred	521,520	
Other underwriting expenses incurred	<u>1,769,407</u>	
Total underwriting deductions		<u>3,233,166</u>
Net underwriting gain		93,952

Investment Income

Net investment income earned	\$ 234,009	
Net realized capital losses	<u>161,202</u>	
Net investment gain		395,211

Other Income

Net loss from agents' premium balances charged off	\$ (3,262)	
Finance and service charges not included in premiums	13,161	
Aggregate write-ins for miscellaneous income	<u>201</u>	
Total other income		<u>10,100</u>
Net income before federal and foreign income taxes		498,903
Federal and foreign income taxes incurred		<u>85,909</u>
Net income		<u>\$ 412,994</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009		\$9,296,430
Net income	\$ 412,994	
Net unrealized capital gains	208,876	
Change in nonadmitted assets	(24,353)	
Change in net deferred income tax	<u>(202,622)</u>	
Change in surplus as regards policyholders for the year		<u>394,895</u>
Surplus as regards policyholders, December 31, 2010		<u>\$9,691,325</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2010

Surplus as regards policyholders, December 31, 2006, per Examination	\$ 8,845,609
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	Gain in Surplus	Loss in Surplus
Net income	\$ 1,507,010	\$
Net unrealized capital losses		1,098,153
Change in net deferred income tax	260,308	
Change in nonadmitted assets	176,551	
Total gains and losses	\$ 1,943,869	\$ 1,098,153

Net increase in surplus as regards policyholders	<u>845,716</u>
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Surplus as regards policyholders, December 31, 2010, per Examination	<u>\$ 9,691,325</u>
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COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Preferred Stocks

A review of the Company's preferred stocks disclosed that the Company did not comply with the National Association of Insurance Commissioners (NAIC) Securities Valuation Office (SVO) filing guidelines that requires all securities not considered filing exempt to be filed with the NAIC SVO. It is recommended that the Company comply with the SVO filing guidelines as stated in the Purposes and Procedures Manual of the NAIC SVO or maintain documentation for filing as provisionally exempt if the preferred stock meets the criteria.

(2) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2010 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Reinsurance (Page 5): It is recommended that the Company revise its reinsurance agreements to comply with California Code of Regulations, Title 10, Chapter 5, Article 3, Section 2303.13(b).

Preferred Stock (Page 10): It is recommended that the Company comply with the NAIC SVO filing guidelines as stated in the Purposes and Procedures Manual of the NAIC SVO or maintain documentation for filing as provisionally exempt if the preferred stock meets the criteria.

Previous Report of Examination

Accounts and Records – (Page 5): It was recommended that the Company institute steps to strengthen its information systems controls. The Company is now in compliance.

Uncollected Premiums and Agents' Balances in the Course of Collection – (Page 9): It was recommended that the Company report its deferred installment under Deferred Premiums and Agents' Balances and Installments Booked but Deferred and Not Yet Due, line 13.2 of the Annual Statement. The Company is now in compliance.

Advance Premium (Page 9): It was recommended that the Company comply with Statements of Statutory Accounting Principles 53, paragraph 13. The Company is now in compliance.

Aggregate Write-ins for Liabilities (Page 10): It was recommended that the Company comply with California Insurance Code Section 11558. The Company is now in compliance.

ACKNOWLEDGMENT

Acknowledgement is made of the cooperation and assistance extended by the officers and employees of the Company during the course of this examination.

Respectfully submitted,

/s/

Yania M. Munro
Associate Insurance Examiner
Examiner-In-Charge
Department of Insurance
State of California